

DHHS POLICIES AND PROCEDURES

Section IV:	General Administration
Title:	Subrecipient Monitoring Manual
Chapter:	Allowable Costs/Cost Principles
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Allowable Costs/Cost Principles

All costs charged to state or federal funds must be reasonable and necessary for the operation and administration of the program(s) for which funding is received. Some funding sources limit the amount of funding available for administration. In that case, to be allowable the costs must not only be reasonable and necessary but must be within the constraints of the funding source. Costs must be reduced by any applicable credits, such as credit memoranda or refunds, and must be supported by appropriate documentation (invoices, purchase orders, etc.) Costs must also be treated consistently, one (1) cost cannot be treated as direct if the same cost is treated as indirect. For example, the executive director's salary can't be charged to a specific federal funding source one (1) month and treated as indirect cost the next.

If an agency performs more than one (1) service or receives funding from more than one (1) funding source, an acceptable method of allocating costs must be in place. Different types of agencies are governed by different cost principles promulgated by the federal OMB:

State, Local, and Indian Tribal Governments	Circular A-87
Educational Schools	Circular A-21
Non-Profit Agencies	Circular A-122

For-profit agencies are governed by the cost principles outlined in the Federal Acquisition Regulation (FAR) and publicly-owned hospitals and other providers of medical care are governed by the regulations at 45 CFR part 74, appendix E. The cost principles for all agencies are fairly consistent, but there are differences between the various regulations. Exhibits 1 and 2 of the Compliance Supplement for OMB Circular A-133 (http://www.whitehouse.gov/omb/grants/grants_circulars.html) show in table form the differences in treatment of various costs between the three (3) OMB Circulars. Subrecipients should be following the appropriate cost principles. All the cost principles outline various allowable and unallowable costs. Examples of common unallowable costs under most federal and state programs are the purchase of alcoholic beverages or the purchase of personal items for employees.

Indirect cost is a specific type of cost that allows an agency to recover a portion of its general administrative expenditures related to the administration of state and federal programs. To be

an allowable expense the indirect cost must be computed in accordance with the applicable federal cost principles. Some agencies with which DHHS Divisions contract, such as universities, are large enough to have indirect cost plans approved by a cognizant federal agency. Others, such as most local governments or non-profit agencies, may charge indirect cost if their plan has been prepared in accordance with the applicable cost principle and has been audited by a CPA firm. Indirect cost is not applicable to for-profit agencies since those expenses are covered in their profit margin.

Suggested Monitoring Procedures:

For subrecipients assessed as low risk:

1. Review compliance supplements, OMB Circulars, grant award documents and state statutes to identify the types of costs that are either specifically allowed or prohibited by the laws, regulations, and the provisions of contract or grant agreements pertaining to the program and the subrecipient.
2. Review the internal control information to determine if the information indicates that procedures are in place to identify costs and expenditures that are not allowable from state or federal funds.
3. Ask the agency which federal cost principles govern its operation to determine if the agency is following the appropriate guidelines.
4. Review expenditure reports/requests for funds to determine if funding is being requested/reported only for allowable costs.
5. If the agency charges for indirect cost, request copies of the approval letter from the cognizant federal agency or ask the subrecipient if their rate has been determined in accordance with the applicable cost principles and has been audited by a CPA firm.

For subrecipients assessed as medium risk:

In addition to activities outlined above for low risk subrecipients:

1. Request a copy of agency's cash disbursements journal or general ledger to determine if all expenditure accounts charged to the program appear to relate to allowable expenditures.
2. Request a copy of the subrecipient's cost allocation plan to determine if the allocation bases appear to be reasonable.
3. Request a copy of the agency's indirect cost plan, if it was not approved by a cognizant federal agency, to determine if it appears to have been prepared correctly.
4. Review the charges for indirect cost to determine if the indirect cost rate has been applied correctly.

For subrecipients assessed as high risk:

In addition to activities outlined above for low and medium risk subrecipients:

1. Select a random sample of expenditures over several months. Pull invoices from several categories of expenditures, including salaries.
 - A. Review to ensure that cost is allowable – no expenditures for personal items, loans to employees, etc.
 - B. Review to ensure that expenditures are properly supported by invoices, purchase orders, receiving slips, etc.
 - C. For payroll expenses, review to ensure that salaries agree with personnel records and that fringe benefits have been properly computed.
 - D. Review to ensure that invoices have received proper approval.
 - E. Review to ensure that credit memoranda and refunds have been deducted from invoices.
2. Review the actual cost allocation information for a month to determine if costs were allocated in accordance with the cost allocation plan.
3. Review the general ledger in comparison to the expenditure report submitted to the division to ensure that expenditures reported equal actual expenditures.

Documentation:

Monitoring Tool/Instrument
Working Papers
Summaries
Monitoring Results Report

For questions or clarification on any of the information contained in this policy, please contact [Office of the Controller](#). For general questions about department-wide policies and procedures, contact the [DHHS Policy Coordinator](#).